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**FIRST - TIER TRIBUNAL
PROPERTY CHAMBER
(RESIDENTIAL PROPERTY)**

Case Reference : **CHI/43UF/LIS/2018/0006**

Property : **Harlow Court,
Wray Common Road,
Reigate, RH2 0RJ**

Applicants : **Jonathan and Maria Brett**

Representative : **In person**

Respondent : **Harlow Court Limited**

Representative : **Justin Bates (Counsel, instructed
By CMS Cameron McKenna
Nabarro Olswang LLP)**

Type of Application : **s.27A 1985 Act**

Tribunal Members : **Judge D Dovar
Mr B H R Simms FRICS**

**Date and venue of
Hearing** : **4th July 2018, Staines**

Date of Decision : **7th August 2018**

DECISION

1. This an application under s.27A of the Landlord and Tenant Act 1985 for the determination of the payability of service charges for the years ending 2016 to 2019.
2. The application was made in February 2018 and directions were given that month, and the following, which provided for disclosure, statements of case and witness statements.

Inspection

3. On the morning of the first day, the Tribunal, accompanied by the parties, inspected the Property.
4. Harlow Court is a traditional, purpose-built, three-storey block of self-contained flats approached from three common hallways and stairs. It is built of brick with a pitched, tile-covered roof. The building has brick elevations with some 'Juliet' balconies and modern double-glazed windows. The block is located on a corner plot at the junction of Wray Common Road and Reigate Road and has open gardens to the front laid mainly to lawn with a narrow service road. To the rear is a further grassed area with two blocks of garages. There is no visitor parking. The building and common areas are in serviceable and mainly satisfactory condition. The garages are generally not in satisfactory order. The Applicants' property is a flat on the ground floor at the South West corner of the block.

Lease Terms

5. The original lease for the Applicants' flat ('the Flat') is dated 18th January 2011 ('the Original Lease') is for a term of 99 years from 18th January 2011 and contains the following material provisions.

6. Clause 1 stipulates that the rents are to be paid

'by equal half yearly payments in advance on the Twenty fifth day of March and the Twenty ninth day of September in each year ...'

7. Clause 3(2) contains the service charge machinery, by which the tenant covenants to pay by clause 3 (2) (b)

'such sum in advance and on account of the Maintenance Charge as the Lessors' Surveyor shall specify at his discretion to be a fair and reasonable interim payment...'

8. The Maintenance Charge is the Lessee's percentage of the Annual Cost (in this case 5.56%; i.e. each of the 18 flats paying an equal share), which itself is the expenditure

'incurred or to be incurred by the Lessors in any Accounting Period in carrying out their obligations under Clauses 4 and 5 (b) hereof or as a forward payment towards any large item of expenditure to be incurred in a subsequent Accounting Period as part of a Sinking fund' (clause 3 (2) (a) (ii)).

9. The interim payment is to be paid by equal instalments in advance on the rent days; i.e. 25th March and 29th September in each year.

10. In terms of end of year reconciliation, Clause 3 (2) (d) and (e) provide that if there is any deficit between actual expenditure and the budgeted demand, then

'the Tenant shall pay the difference to the Lessors within Twenty eight days of the service upon the Tenant of a Certificate of the external Auditors of the Lessors' . In the event of a surplus 'the difference (being the unexpended surplus) shall be accumulated by the Lessors and shall be applied in or towards the Annual Cost in the next succeeding or future Accounting Period or period ...'

11. In terms of the Lessors obligations, clause 4 sets out a variety, which include

'(i) to keep proper books of account and vouchers relating to all costs charges and expenses incurred,

(j) generally to do all other things reasonably desirable to maintain the Building and the Community Land as a respectable block of private residential flats and gardens ancillary thereto'

12. On 17th March 2014, a new lease of the Flat was granted for a term of 999 years from 25th September 2013 on the same terms as the original lease save with some variations ('the New Lease'). In particular, by clause 7.2.3 the Tenant covenanted

'To pay to the Landlord within 14 days of a written demand a proportion of the administration and other costs (including

professional fees) of Harlow Court Limited such proportion reflecting the Tenant's shareholding in Harlow Court Limited.'

13. The Tribunal were informed that each of the leaseholders has an equal share in the Respondent company.

Preliminary matters

14. By reason of a convention adopted by both the landlord and the leaseholders in respect of the Property, the only service demands that are issued are on account demands in the same amount; being £800 every 6 months. This gave rise to two preliminary matters: firstly, whether the Respondent had adhered to the procedure set out in the lease for demanding service charges; secondly, the remit of the tribunal's jurisdiction to determine the payability of service charges under s.27A.

Compliance with formalities

15. In respect of the first issue, the Respondent candidly accepted that they had not adhered to the service charge mechanism in the lease, but contended that there had been an estoppel by convention in that regard. On the second day of the hearing, the Applicants stated that they would not be taking any issue with the validity of the demands and so this issue fell away.

Jurisdiction

16. The second issue requires a little more background and again relates to the manner in which service charges have been historically collected. In about early 2014, the leaseholders purchased the freehold of the Property.

From that point, the directors of the Respondent company were drawn from the leaseholders and, until around August 2016, Mr Brett, one of the Applicants, had been a director.

17. Since 2014, partly at the instigation of Mr Brett, as director, the Respondent had made two on account demands each year in the sum of £800. This was a practice that had been carried over from the pre-freehold acquisition days. Mr Brett explained that it had been put in place in order to keep the payments smooth and provide stability. Of the £800 demanded, part was put towards annually recurring costs and part to a reserve fund. The Applicants claimed that the latter had been demanded, allocated and accrued in anticipation of a capital expenditure programme being instigated. However, no such programme had materialised and therefore they contended that this sum should be paid back to the leaseholders.
18. Invariably insufficient funds were demanded through the on account demand to meet the annually recurring costs with the result that there was a deficit. However, rather than utilise the mechanism in the lease to recover the deficit from the leaseholders, the Respondent dipped into a fund that was transferred to it when the freehold was purchased ('the Residents' Fund'). Mr Brett stated that the intention had been to wind down this fund rather than charge the leaseholders additional service charges to make up any deficit. The Applicants also objected to the fact that this fund had since been transferred into and merged with the reserve fund.

19. Therefore, since at least 2014, there had been no demands made based on actual expenditure nor any proper reconciliation between budgeted service charge and actual service charge. The accounts provided, which were the Respondent's company accounts - not strictly service charge accounts, included transfers in from the Residents' Fund. When needed, money had simply been taken from the Residents' Fund. Further, in respect of the years that were challenged in this application, there was no intention from the Respondent to make any deficit demands, nor had they done.

20. In the Tribunal's view, given that no demand was to be made in respect of actual costs, no proper reconciliation had been carried out between budgeted expenditure and actual expenditure and that contribution to the service charge costs (for any amount over that budgeted for) was met out of the Residents' Fund, its jurisdiction was limited to dealing with the on account demands that had been made.

21. Any issue that the Applicants had with regard to drawing money from the Residents' Fund was not a matter for determination under s.27A, but may be by way of a challenge that monies were being wrongly withdrawn from the fund; which, if it had been accumulated from historical service charge payments, may well be subject to a trust imposed by s.42 of the Landlord and Tenant Act 1987, with the leaseholders as beneficiaries.

On Account Challenges

22. In light of the above, the Tribunal was left with a challenge to the on account demands for the years in question. As stated above this amounted to £1,600 per annum.
23. On this issue the Tribunal heard evidence from Ms Utting on behalf of the Respondent. She was not able to give precise details of how the budget had been arrived at. In truth, the budgets were set by allocating the pre-determined figure of £1,600 per leaseholder per unit. In respect of individual items she was only able to say that generally budgets were set by consideration of the previous years expenditure and any known differences for the forthcoming year.
24. There were a number of challenges to the individual items. They fell into two different categories. One being that certain items were not recoverable under the lease terms, this related to accountancy fees, legal and professional costs, management fees and directors and officers insurance. The other being that the budgeted amount was too high.

Recoverable under the lease

25. The Respondent contended that when construing the terms of the lease it was important to bear in mind that, as of 2014, these were costs incurred by a lessee owned freehold company, with no other income. Further, that in construing the terms, the Tribunal should exclude the fact that the majority of the terms were written in 2011, when there was a private landlord. Instead, as the New Lease had been granted post acquisition, it should be construed against the matrix of fact pertaining at that time.

26. After the lessees had purchased the freehold they had granted themselves new, longer, leases of their flats. Whilst the lease terms remained substantially the same, there were a series of further covenants that were introduced with the result that there were now in effect three different types of service charge: those under clause 5 of the original lease; and those under clause 4 (insurance); and those under clause 7 of the New Lease. All of those, it was said, fall within the definition of service charge in s.18 of the 1985 Act.
27. The Respondent submitted that clause 7.2.3 was intentionally drafted very broadly and that there was no reason why in principle it could not cover accountants fees, directors and officers insurance as these were all part of the administration of the landlord. Without the latter, it would be difficult to get anyone to be a director of the respondent company.
28. It was also contended that legal fees were within scope of professional fees and related to management.
29. In support of these contentions, the Respondent relied on two authorities. The first *Solarbeta Management Company Ltd v Akindele* [2014] UKUT 0416 (LC), where it was said that in the context of a lessee owned management company, that if it could not discharge its own costs then it would become insolvent and that that would have been known by the draftsman of the lease. Therefore not only should the lease be construed in light of that in general, but also no sensible distinction could be made between the costs incurred in managing the estate and the costs incurred in managing the management company.

30. Alternatively the Respondent relied on *Embassy Court Residents' Association v. Lipman* (1984) 271 EG 545, to imply such a term on the basis that there was no other way of paying for these essential services.
31. It was accepted that if the Respondent had been a private landlord, then their case would be harder to argue.
32. The Tribunal does not agree. At the time clauses 3, 4 and 5 of the Original Lease were drafted, they intended to cover the service charge costs that were recoverable in the context of a private landlord recovering a ground rent. There was no provision at that time for the company administration costs to also be recoverable under the service charge. The New Lease made provision for that at clause 7.
33. The wording of 7.2.3 is sufficiently clear in that regard in that:
 - a. It refers to 'Harlow Court Limited' not to the Property itself;
 - b. The payment is linked to share-holding, rather than the service charge proportion under the lease.
34. Therefore in the view of the Tribunal, whilst the authorities relied on by the Respondent, set out above, suggest that when construing lease terms, there is some pressure to elide the costs of management with the costs of administration, the particular facts of this case suggest the opposite.
35. Whilst the Tribunal sees the force in the points put forward by the Respondent in relation to what is essentially a construction argument (both express and implied terms), ultimately in relation to the Original Lease terms incorporated into the New Lease, the Tribunal considers that

it cannot be ignored that when the words were actually written, the landlord was a private landlord. Since then, the only alteration that had occurred was the nature of the landlord. That was not sufficient to cause the words to change their meaning which on a plain and natural interpretation do not cover all of the expenses contended for by the Respondent. In the Tribunal's view in this case there is a distinction to be drawn between the administrative costs of the company and the costs of managing the Property. Whilst clause 7.2.3 does refer to 'other costs', that must be limited by and read in the context of the dominant and specified cost of 'administration' and in the Tribunal's view it must be linked to the administration costs of the company and is not wide enough to encompass any cost incurred; particularly the costs of managing, given that that has, where appropriate, been provided for in clauses 3, 4 and 5.

36. Further, although reliance was placed on *Lipman* in the alternative, that is ultimately again a question of interpretation and accordingly for the same reason fails.
37. Against that background, the following items were challenged as not being recoverable under the terms of the lease.

Accountancy fees

38. The Applicants contended that the clause within the lease under which they were potentially recoverable was under clause 7.2.3; which was contained in the New Lease. The Applicants stated that that was not capable of being subject to an on-account charge as it required payment after the service had been provided within 14 days.

39. In respect of clause 4 (i), the Applicants stated that keeping books and vouchers was a different matter to producing accounts.
40. Countering those arguments, the Respondent stated that:
- a. none of these costs had to be incurred prior to a demand being made. Clause 5 of the New Lease linked the payments under clause 7 to the rent payable under the terms of the Original Lease, which is paid in advance; and
 - b. in addition to clause 7 of the New Lease terms, the fees fell under clause 4 (i) which was to 'keep proper books of account'. Further, clauses 3 (2) D) and (f) envisaged the provision of an accountancy service and there was no way of doing that without producing accounts.
41. The Tribunal agrees with the Applicants in that it does not consider that the costs of accountants fall within clause 4 (i); the keeping of books of account is different from producing accounts.
42. However, it does consider that the costs fall within clause 7.2.3 in that those costs are directly related to the company costs. As stated above, these were not strictly service charge accounts but the Respondent's company accounts. Further, the Tribunal agrees with the Respondent's submissions that these costs are recoverable in advance.
43. Accordingly, the costs budgeted for accountants' fees, being those for producing company accounts, are recoverable but separately from the Maintenance Charge in the manner expressed in 7.2.3.

Directors and Officers insurance

44. Directors and Officers insurance falls more clearly within 7.2.3 as it is directly related to the administration of the Respondent company and not to managing the Property per se. Further, the Tribunal agrees with the Respondent's submission set out above that these sums, being labelled as rent, are recoverable in advance.

Management and Legal Fees

45. In relation to management and legal fees, the Tribunal does not consider that the costs fall within clause 7.2.3 in that these costs are not directly related to the administration of the company, but are for managing the Property. It also does not consider, for the reasons set out above, that they fall within any of the terms of the Original Lease.
46. In that regard, the following sums are disallowed from the budgets:
- a. 2015/16 - £3,672 (Management Fees);
 - b. 2016/17 - £3,750 (Management Fees);
 - c. 2017/18 - £4,860 (Management Fees), £500 (Legal & Professional Fees);
 - d. 2018/19 - £5,400 (Management Fees), £2,500 (Legal & Professional Fees).

Reserve fund

47. The Applicants accepted that a reserve fund was in principle recoverable under the lease, but complained that the sums demanded were excessive as no one had properly thought about what the actual costs were. No one had identified an item of expenditure and so the budgeted amounts were not allowable.
48. The Tribunal disagrees. The reserve fund provisions are very wide and do not require actual expenditure to be identified. In any event, the Tribunal was told about the imminent decoration works which would deplete entirely the reserve fund.

Cleaning and window cleaning

49. Finally, the Applicants challenged the budgeted cleaning and window cleaning costs. Although high, the costs were not so large as to warrant an adjustment at the budgetary stage.

Section 20C

50. The Applicant asked for an order under s.20C based upon an optimistic view of this application and that some money had already been refunded.
51. The Respondent considered that the costs were recoverable under clause 7.2.3. It resisted an order, but did say that its legal costs were covered by insurance. It was stated that all the Applicant had done by this application was to make it likely that the Respondent would comply with the strict terms of the lease with the result that service charges would increase.

52. For the same reasons as above, the Tribunal does not consider that the costs of this application are recoverable under clause 7.2.3 as they do not relate directly to the administration of the Respondent company.
53. In any event, the Tribunal makes a limited order under s.20C to cap the Respondent's costs at £1,500. The Applicants have been partially successful. However, the Tribunal will not order any refund of the application and the hearing fee given that Mr Brett has in some parts been the author of his own misfortune.

A handwritten signature in black ink, appearing to read 'D. Dovar', with a long, sweeping horizontal flourish extending to the right.

Judge D Dovar

Appeals

A person wishing to appeal this decision to the Upper Tribunal (Lands Chamber) must seek permission to do so by making written application to the First-tier Tribunal at the Regional office which has been dealing with the case.

The application must arrive at the Tribunal within 28 days after the Tribunal sends to the person making the application written reasons for the decision.

If the person wishing to appeal does not comply with the 28-day time limit, the person shall include with the application for permission to appeal a request for an extension of time and the reason for not complying with the 28-day time limit; the Tribunal will then decide whether to extend time or not to allow the application for permission to appeal to proceed.

The application for permission to appeal must identify the decision of the Tribunal to which it relates, state the grounds of appeal, and state the result the party making the application is seeking.